Testimony of Clint Fall, General Manager
First District Association

before the

House Committee on Agriculture
Subcommittee on Department Operations, Oversight, Dairy, Nutrition and Forestry
Winona, Minnesota Field Hearing

"Review of the State of the Upper Midwest Dairy Industry"

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Chairman Gutknecht, Congressman Peterson, Members of the Subcommittee-

My name is Clint Fall, President and CEO of First District Association. I want to thank you for the opportunity to testify today regarding the status of the Upper Midwest dairy industry, and to give you the perspective of our members on that important topic.

The dairy sector is extremely important to the economy of the Upper Midwest, particularly Minnesota and Wisconsin. Minnesota's dairy sector annually pumps more than $1.2 billion into our state economy, and the total economic impact of Minnesota's dairy production is estimated to be $3.1 billion. The total employment impact of Minnesota's dairy industry is estimated to be 27,402 jobs, including direct employment of 6,111 jobs and indirect or induced employment of 21,291 jobs. When the multiplier effects are fully considered, it is estimated that each Minnesota dairy cow generates $5,000 in economic activity for the state.[1]

According to the Wisconsin Milk Marketing Board, Wisconsin's dairy industry has a $20.6 billion impact on the state's economy and employs 160,000 people, accounting for nearly 40 percent of all Wisconsin agriculture jobs. The economic impact of dairy farming in Wisconsin is more than twice as large as the citrus industry's economic impact in the state of Florida and eight times as large as the potato industry's economic impact in the state of Idaho. The average Wisconsin dairy cow generates more than $17,000 a year in economic activity, which circulates throughout local communities.[2]

First District Association is a dairy farmer-owned cooperative based in Litchfield, Minnesota. The farmer-members for First District are located in Minnesota, Wisconsin, and Iowa and produce over 1.7 billion pounds of milk per year. Over 120 million pounds of Cheddar cheese, 22 million pounds of whey protein concentrate and 32 million pounds of lactose are produced annually. Our single cheese processing plant in Litchfield is a state-of-the art operation, and one of the few processing plants with the technical

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[1] Governor Tim Pawlenty's Livestock Advisory Task Force Report, June 2004, pp. 8-10
[2] http://www.wisdairy.com/AdvertisingAndNews/DairyImpactCampaign/default.aspx

capability to extract dairy calcium. Our customers include the largest chocolate manufacturers, infant formula manufacturers, bakery companies, dairy food processors (yogurt, cream cheese, processed cheese) and pharmaceutical companies.

I am particularly pleased to be part of this panel of my colleagues representing dairy processing companies, because it is an excellent opportunity to point out how critical farmer-owned cooperatives are in the dairy processing sector, not only in the Upper Midwest, but also in the nation as a whole. In Minnesota and Wisconsin, about 85 percent of milk is marketed through cooperatives. It is estimated that 60-65 percent of cheese, and nearly 100 percent of butter and milk powder in Minnesota and Wisconsin are processed by cooperatives.

As a dairy farmer member-owned processing and manufacturing cooperative, our goal is to maintain a competitive operation, not only to provide our farmers a fair price for their milk, but also to return a profit to them from the dairy products that we produce and market.

As a member of the Midwest Dairy Coalition and the National Milk Producers Federation, we are also active in supporting federal dairy policies that are beneficial to dairy farmers of the Upper Midwest and the nation as a whole.

Dairy is highly regulated. The structure of federal dairy policy has always played a significant role in the status of the Upper Midwest dairy industry, although not always for the better. There has been a tendency in federal dairy policy to promote high minimum prices for Class I (fluid) milk and to instill policies that put downward pressure on the prices for manufactured dairy products. Whether it is the ongoing structure of the federal milk marketing order system, or past experiments with regional dairy Compacts, federal dairy policy has often placed the Upper Midwest at a competitive disadvantage. For the Upper Midwest, where about 85 percent of our milk is manufactured into cheese, butter, and powder, anything that artificially inflates the price of Class I at the expense of manufactured classes of milk is detrimental to our region.

Therefore, one of our clear policy goals has been to promote policies that treat producers in the Upper Midwest more equitably, and to work to reform or eliminate those policies that discriminate against our region.

As we move into the debate over the structure of the next farm bill, I would like to make several points about policies that are important to our producers and the Upper Midwest dairy industry as a whole.

Milk Price Support Program

The milk price support program has been the core base of support for milk and dairy product prices for decades. Without a doubt, it is an important program that should be continued. But equally clear is that the milk price support program is in great need of reform. The current price support level of $9.90 per hundredweight is a very low level of support. But even at that low level, the current price support program has proven to be a porous and ineffective floor. Between January 2000 and February 2003, the Class III price fell below support in 12 of 37 months, falling as low as $8.57 in November of 2000.

The central premise of the milk price support program is that dairy product manufacturers will sell dairy products to the Commodity Credit Corporation whenever market prices fall below the product purchase prices established by USDA. Yet what we are seeing is that manufacturers are reluctant to sell product, particularly cheese, to the CCC. One of the key reasons for this is that the costs of selling product to the CCC are higher than the costs of selling to the commercial market. These higher costs are associated with CCC processing and packaging standards and inspection and grading requirements that are different from industry standards. In addition, storage and finance costs are higher because it takes longer for the CCC to take delivery of product and make payment.[3]

To address these unique costs associated with selling surplus product to the CCC, we support a proposal by NMPF to increase the purchase prices for cheese, nonfat dry milk and butter, to reflect those unique costs. I believe these changes could be made administratively by USDA in order to better enforce the current statutory price support of $9.90 per hundredweight. However, because USDA appears unwilling to make these necessary changes without Congressional direction, I believe that these changes should be made in statute as part of the 2007 farm bill.

Milk Income Loss Contract (MILC) program

Because of the inadequacy of the milk price support program as a safety net, First District Association and other members of the Midwest Dairy Coalition argued during the last farm bill debate that an additional program should be established to provide a more credible safety net for dairy producers, and that such a program should be national in nature to provide benefits to all producers. Fortunately, others agreed. The Milk Income Loss Contract (MILC) program that emerged out of the 2002 farm bill has proven to be a very effective safety net, and has helped us move away from some of the contentious inter-regional conflicts that were commonplace in dairy in the late 1990s and the early part of this decade, particularly with regard to regional dairy compacts.

Because of the counter-cyclical nature of the MILC program, the program has proven to be very cost effective. Assistance is only provided to producers when market prices fall below target levels and remains dormant when market prices are strong. Indeed, the MILC program was dormant for much of 2004 and 2005. Without question, our producers would far prefer to see market prices remain strong so the MILC program would remain dormant. However, when prices do fall to low levels, as they did in 2002 and the first half of 2003, and as we are seeing currently, the assistance provided by the MILC program has been critical.

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[3] Jesse, Ed, "Flooring the Support Price for Milk," Marketing and Policy Briefing Paper, University of Wisconsin-Madison, College of Agricultural and Life Sciences, Department of Agricultural and Applied Economics, March 2003. (http://www.aae.wisc.edu/future/publications/m_P_pb_81_flooring.pdf)

One of the other tools used by Congress to improve the effectiveness and limit the taxpayer costs of the MILC program has been to place a volume cap to limit the benefits to the first 2.4 million pounds of production per operation, roughly equivalent to the production of about 135 cows. All producers are eligible for benefits, but not beyond the 2.4 million pound annual cap. It is important to note that 83 percent of all dairy farms in the nation are fully covered under this cap. Yet even those that exceed the cap receive great benefits.

The MILC program has proven beneficial to the vast majority of dairy farms in the nation. With regard to the Upper Midwest specifically, there is no doubt that the program has helped us to maintain our productive capacity during low milk price cycles. In that context, it is worth noting that dairy cow numbers in Wisconsin increased in 2005. This is the first time since 1994 that January-December dairy cow numbers in Wisconsin have not shown a reduction.[4] Arguably, the MILC program is one of the factors helping our region turn around.

As we move into the next farm bill debate, it is critical for our dairy industry and our rural communities that the MILC program or a similar type of counter-cyclical safety net program be continued.

Consistency in our Trade Policies and Tariff Schedules

Gone are the days when the U.S. dairy sector could operate without regard to the global market. The opportunities and challenges of international trade are a reality for U.S. dairy. In that regard, it is critical that we review our trade policies and those of our trading partners, to assure that we have consistent and rationale policies as we move into the future. Specifically, during the Uruguay Round of WTO trade negotiations, tariff rate quotas were placed on imports of traditional dairy import product classes such as cheese, butter, and nonfat dry milk. However, we failed to recognize emerging trends in international trade, particularly with regard to milk protein concentrates (MPCs), and we failed to create tariff rate quotas on those milk protein products consistent with other dairy product classes. As a result, we have seen instances in recent years during which MPC imports to the United States have surged.

In March of 2001, a General Accounting Office study requested by Congress determined that MPC imports increased 56-fold from 1990 to 1999, with a near doubling of the MPC imports in 1999 alone.[5] Not only do these import surges affect farmers' milk prices domestically, they also have a cost to taxpayers. In a May 2004 study by the International Trade Commission, it was determined that about 35 percent of the Commodity Credit Corporation stock build up of nonfat dry milk between 1996 and 2002

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[4] Status of Wisconsin Agriculture 2006, University of Wisconsin-Madison, College of Agricultural and Life Sciences, Department of Agricultural and Applied Economics http://www.aae.wisc.edu/pubs/status/

[5] http://www.gao.gov/new.items/d01326.pdf, p. 4

was attributable to displacement of domestically produced nonfat dry milk by imported milk protein products.[6]

After several years of declines in MPC imports, MPC imports are once again increasing. It is critical that we modify our tariff schedules to place tariff rate quotas on MPCs and casein, as proposed in H.R. 521, introduced by Congressmen Obey and Sherwood. This legislation would not attempt to stop MPC and casein imports altogether. It would merely place commonsense limits to assure that the U.S. doesn't experience major surges of MPC imports again, as we did in the 1990s. The United States is currently the only dairy import-sensitive nation in the world that has not imposed such limits on MPC imports. It's time for us to push for more consistency in our tariff schedules, and to fully recognize and respond to our own market vulnerabilities, as have many of our trading partners.

Conclusion

There is no question that the Upper Midwest Dairy Industry is in the process of becoming more competitive. The Upper Midwest has enjoyed, and will continue to enjoy, many comparative advantages in dairy production and processing. We must work together to achieve the necessary efficiencies to remain competitive, especially with the West and Southwest. This will probably require modifications in traditional premium structures, as well as efforts to provide producers with more accurate information about hauling and transportation costs in an effort to reduce those costs. But as we make these shifts, we need to make sure to keep the interests of this valuable industry and producers at the forefront. We must recognize that federal dairy policy must play a role in that process. It is our job to insist on policies that treat our region fairly and equitably.

I thank you for this opportunity to testify.

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[6] http://hotdocs.usitc.gov/docs/pubs/332/pub3692.pdf, pp. 9-3 and 9-15